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May 16, 1996

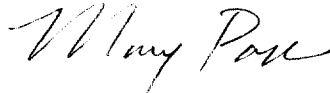
Mr. William F. Caton  
Acting Secretary  
Federal Communications Commission  
1919 M Street, N.W., Room 202  
Washington, D.C. 20554

Re: The Lincoln Telephone and Telegraph Company  
CC Docket No. 96-98

Dear Mr. Caton:

On behalf of the Lincoln Telephone and Telegraph Company ("Lincoln"), enclosed for filing you will find an original and sixteen copies of Lincoln's comments in response to the Commission's Notice of Proposed Rulemaking in the above-referenced proceeding. Date-stamped acknowledgment of this filing is requested. Any questions concerning these comments should be directed to the undersigned.

Sincerely,



Robert A. Mazer  
Albert Shuldiner  
Mary Pape

Counsel for the Lincoln  
Telephone and Telegraph Company

cc: Ms. Janice Myles (1 paper copy and 1 diskette)  
ITS (1 paper copy)

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Before the  
**FEDERAL COMMUNICATIONS COMMISSION**  
Washington, D.C. 20554

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY

In the Matter of )

Implementation of the Local Competition )  
Provisions in the Telecommunications Act )  
of 1996 )

CC Docket No. 96-98

MAY 16 1996

**COMMENTS  
OF  
THE LINCOLN TELEPHONE AND TELEGRAPH COMPANY**

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May 16, 1996

## SUMMARY

The Telecommunications Act of 1996, Section 251, charges the Commission with the responsibility of completing all actions necessary to establish regulations to implement the requirements of that section. Sections 251 & 252 of the Act also delegate substantial responsibility to the states relative to the implementation of the Act. It is Lincoln's position that the proper means to synthesize these two responsibilities is for the Commission to promulgate general principles for the states to use as a guideline, but not to unduly proscribe elements, rules, levels or other constraints that would interfere with the ability of the states to discharge their responsibilities and utilize their experience in their own particular environment.

Lincoln has constructed comments in response to the Notice in three general areas: (1) the practical application of the Act to companies similarly situated to Lincoln, (2) the proper interpretation of the constructs of the Act, and (3) the promulgation of pricing principles that will be effective at the state level in the arbitration process and will ensure the Constitutional and statutory rights of the participants.

Lincoln believes that in the determination of technically feasible interconnection points and the granularity of unbundled elements, the Commission and the states should take into consideration the company's ability to bill the interconnection products, to operationally support the products, and to develop the necessary cost systems to support the negotiation and arbitration process. The Commission and the states should be cautious

of overproscription of interconnection points and unbundled elements and consider substantiated market demand for the product. The best way to meet the above conditions is with a bona fide request structure and joint testing to ensure operational feasibility. Lincoln suggests that the experience gained in the ONA and Expanded Interconnection proceedings can be useful in consideration of such questions as unbundling, terms and conditions, and request response.

It is Lincoln's position that the petition and waiver process described in Section 251 (f) (2) specifically applies to companies similarly situated to Lincoln (i.e. any company with fewer than 2% of the Nation's subscriber lines). Lincoln believes that it is also very important to recognize that the petition and waiver process applies to a requirement or requirements of subsection (b) or (c). This provides the petitioner with the opportunity to obtain waivers of certain aspects of these subsections. In its comments Lincoln also describes some conditions for the test of what constitutes an unduly economically burdensome requirement such as substantial expense which cannot be recovered in the rates and the uneconomic transfer of implicit subsidies.

In Section 251 (b) and (c) of the Act, Congress outlined several constructs to describe the aspects of interconnection. Lincoln sees that the understanding of the application of three of these (Transport and Termination, Unbundled Elements, and Resale of Retail Services) is critical to the implementation of the Act. Fundamental to Lincoln's interpretation is the question, "To which carrier is the local service customer subscribed?". Unbundled Elements and Wholesale of retail services can only be purchased from the

Incumbent LEC by the Competitive LEC if the Competitive LEC has captured the local subscriber or subscribers that they wish to serve with those with components or wholesale services. Transport and Termination, however, applies to a situation whereby two distinct networks require interconnection and the local subscribers have been captured by their respective network providers. Lincoln suggests that uniform use of these guidelines would clear up any confusion in application.

In the area of pricing of unbundled elements, Lincoln believes that evaluation of rates should consider the requirement of every firm to recover its total costs. Lincoln suggests a product level cost principle that ensures the recovery of LRIC, plus contribution to forward-looking joint and common costs, plus contribution to embedded costs. Without adhering to the above principles, the proper economic forces are not actuated and the firm would be in danger of having its property confiscated. These principles are also carried to the discussion of wholesale of retail services that are currently priced below cost. Lincoln believes that a rebalancing of existing rates is necessary to deal with the associated economic problems. Without the proper pricing of products relative to their costs and relative to each other, arbitrage will occur and the goal of facilities-based competition will not be brought to fruition.

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

In the Matter of	)	
	)	
Implementation of the Local Competition	)	CC Docket No. 96-98
Provisions in the Telecommunications Act	)	
of 1996	)	

**COMMENTS  
OF  
THE LINCOLN TELEPHONE AND TELEGRAPH COMPANY**

The Lincoln Telephone and Telegraph Company ("Lincoln"), by its attorneys, hereby submits these comments in response to the Commission's Notice of Proposed Rulemaking in the above-referenced proceeding.<sup>1/</sup> Although the Commission's NPRM addresses a comprehensive range of issues relating to local competition and implementation of Sections 251, 251 and 253 of the Telecommunications Act of 1996,<sup>2/</sup> Lincoln has limited these comments to particular areas of the NPRM.

**I. INTRODUCTION**

As the Commission is aware, Lincoln is a local exchange carrier ("LEC") headquartered in Lincoln, Nebraska providing service to the southeastern portion of the state. Moreover,

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<sup>1/</sup> *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, *Notice of Proposed Rulemaking* (released April 19, 1996) ("NPRM" or "Notice").

<sup>2/</sup> Pub. L. No. 104-104, 110 Stat. 56 ("1996 Act").

the Commission is well acquainted with Lincoln's somewhat unique status among Tier 1 LECs. Even though Lincoln shares many of the concerns and views of Tier 1 LECs, Lincoln's perspective is quite different due to (a) its size relative to some of the other Tier 1 carriers; (b) its overwhelmingly rural service area; and (c) the fact that its service area is confined within one state. As with previous Commission proceedings, Lincoln is pleased to have this opportunity to present some of its views and concerns which arise from its unique situation.

Sections 251 and 252 of the Communications Act of 1996 set forth obligations of telecommunications carriers and therein proscribes a framework for fair and equitable competition in the Local Exchange Market. Section 251 (d) (1) charges the Commission with completing all actions necessary to establish regulations necessary to implement the requirements of this Section.

In the following text Lincoln offers comments on key issues of interpretation as identified in the Notice. Lincoln considers these interpretations to be vital to the practical implementation of the Act and to fulfill the goal of fair and equitable competition. As a general premise Lincoln believes that competition is a means to optimize the general (economic) welfare and, therefore, considerations should be viewed in the context of the overall welfare improvement of the stakeholders (producers, consumers, vendors, shareholders, communities, etc.) of the telecommunications industry. No competitor should prosper if they are economically inefficient, and no economically efficient competitor should be artificially forced to exit the market by regulatory fiat.

In the Act, the states are delegated a significant role in the implementation of the Act. Lincoln believes that it is important for the Commission to assure the role of the state in implementation and at the same time provide an overall framework that can be used as a guide to facilitate the Section 252 negotiation and arbitration requirements. The proper balance of the role of the Commission and role of the states is a major challenge and at the same time is of vital importance. Too much intervention on the part of the Commission will obviate critical aspects of a state's unique environment. Too little intervention will run the risk of randomness of principles and inefficient and ineffective implementation.

Lincoln's response comments are centered around the practical application of the Act to companies similarly situated to Lincoln, the proper interpretation of the constructs in the Act, and the promulgation of pricing principles that will be effective at the state level in the arbitration process and will ensure the Constitutional and Statutory rights of the participants.

## **II. PROVISIONS OF SECTION 251**

### **B. Scope of the Commission's Regulations**

#### **2. Interconnection, Collocation, and Unbundled Elements**

**Para. 50** Lincoln suggests the FCC should establish principles that facilitate and encourage interconnection across the country without excessive proscription of interconnection. The Notice tentatively concludes the Commission should adopt uniform national rules for evaluating interconnection arrangements. Lincoln agrees that clarity in the rules is important. The details of interconnection are best left to negotiation between

the individual parties as was envisioned by Congress in Section 251(c)(1) of the Act. The principles must recognize and accommodate the diverse capabilities of individual LECs and their networks. These capabilities are not just technical. A company must also have the supporting costing and billing systems, and the information that supports those systems, to successfully provide any service. These essential supporting elements are more than just the bare bones technical parameters of physical interconnection.

**Paras. 56-59** The Commission should avoid over proscription of technically feasible points of interconnection. Given the rapid technological developments in communications, any attempt by the Commission to mandate these points to be provided by the incumbent LEC would be overrun. The use of a bona fide request mechanism that responds to market conditions will ensure that interconnection points required by competing carriers will be available as they are needed.

The Commission should consider the requirements in Section 271 of the Act as sufficient to provide competing carriers with the ability to connect to end users and provide competing local service. In conjunction with the examples given by the Commission in Paragraph 57 of the NPRM, line- and trunk-side of switches, transport facilities, tandem facilities, and signal transfer points, are sufficient as a rational entry point into negotiation.

Small and mid-size carriers should be allowed to resolve additional technical feasibility interconnection issues through negotiation with competing carriers. These issues, not mentioned in the NPRM, are operational support systems, cost systems and data, or billing systems. Lincoln urges the Commission to recognize the substantial

investment small and mid-size carriers would need to make if they are required to interconnect networks at the same time, in the same manner or as the result of superficially similar network technologies deployed by the large carriers. Small and mid-size companies do not have the economies of scale and scope available to the large companies. This limitation on ability was recognized by the Congress when it created an exemption process for rural carriers and carriers with less than 2 percent of the nation's access lines (Section 251(f)(2)). While these companies might have a switch that is physically similar to a large company, they may not have purchased the same software modules. A standard of technical feasibility based on only hardware and level of software release could force these companies to offer services that are not supportable in the local marketplace. Small and mid-size companies should not be required to match the requirements of an artificially situated "similar" network.

Lincoln urges the Commission to acknowledge that the only technically feasible points of interconnection for transport and termination of local calls are the trunk side of either the local switch or a tandem switch. This acknowledgment will clarify that transport and termination is not provided through other points of interconnection or through unbundled network elements. Transport and termination of calls must be through a switch. It cannot be provided via other points of interconnection.

**Paras. 60-62** Lincoln submits that the Commission's past experience with the proceedings on Open Network Architecture (ONA)<sup>3/</sup> and Expanded Interconnection should be utilized.<sup>4/</sup> The Notice seeks comment on how to determine whether the terms and conditions for interconnection are just, reasonable and nondiscriminatory. The Commission spent a great deal of time and energy in the development of terms and conditions during both the ONA and Expanded Interconnection proceedings. These efforts, when coupled with the flexibility and inventiveness of the negotiation process, will yield terms and conditions that will meet all of the needs of both the incumbent and the competitive LECs. ONA and Expanded Interconnection provide the foundation of the industry's early experiments with competition and will allow the growth the Commission is seeking for greater competition for local service. The terms and conditions developed in ONA and Expanded Interconnection have already been evaluated as to whether they are just, reasonable, and nondiscriminatory. There is no reason for the Commission to reevaluate what is in place and working today. These terms and conditions include standards for installation, maintenance, and repair. One example, from Lincoln's own expanded interconnection offering, is the interval of 45 days between a bona fide request and filed service for response to interconnector requests for new cross-connects or

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<sup>3/</sup> See CC Docket No. 85-229, (Computer III).

<sup>4/</sup> See *Virtual Collocation Designation Order*, 10 FCC Rcd 1116; *Virtual Collocation Expanded Interconnection Order*, 9 FCC Rcd 5154; *Special Access Physical Collocation Designation Order*, 8 FCC Rcd 6909; *Special Access Interconnection Order*, 7 FCC Rcd 7369.

additional wire centers<sup>5/</sup>. This section of Lincoln's tariff also contains examples of terms and conditions for construction intervals, insurance, access, and many other items the Commission has already reviewed and deemed workable<sup>6/</sup>.

The additional issues on which the Commission requests details are best left to negotiations between the parties and state arbitration where they are not already addressed in the ONA or Expanded Interconnection proceedings. These agreements would then be available to other carriers.

**Paras. 83-84** Lincoln agrees with the Commission that network elements can be facilities, equipment, features, functions or capabilities of the network used to provide telecommunications services and are not the services themselves. The Commission seeks comment on the appropriate definition of "network element." Lincoln urges the Commission to allow the negotiation process to determine the level of unbundling requested by competitors in the market. A bona fide request process would allow the market to decide the level of required unbundling.

Lincoln suggests that the Commission adopt a framework similar to that developed in the Expanded Interconnection proceeding as appropriate to interconnection and unbundled network elements for local service competition. Expanded Interconnection was designed to support competition. Its guidelines on elements could be used to encourage competition in the rest of the network. Many of the issues raised in this Section 251

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<sup>5/</sup> Lincoln's Tariff F.C.C. No. 3, Section 8.1.2, page 31.1.2.

<sup>6/</sup> Lincoln's Tariff F.C.C. No. 3, Section 8.

proceeding have already been addressed in Expanded Interconnection. For example, the interfaces for the cross-connects between the competitor's and Lincoln's equipment are direct and at industry standards. This simplifies the installation and administration of interconnection. It also encourages the opening of the incumbent LEC's network to competition as required by the Act.

Lincoln believes that the ONA proceeding, while allowing enhanced service providers access to unbundled rate elements in order to compete with the BOCs, has not been completely successful. ONA has fostered an excessive unbundling of the network, even to the point where some BSEs were created by carriers but never ordered by customers. This non-functional unbundling can be avoided by participation in a bona fide request process whereby the elements unbundled are actually required by the competing carrier. ONA has elements that are of little use to most carriers in the construction of network services. As was stated previously in these comments, Lincoln urges the Commission to codify the requirements in Section 271 of the Act for network elements as a minimum starting point for negotiation to provide competing carriers with the ability to connect to end users and provide competing local service. Lincoln also reiterates that transport and termination of calls is not provided through unbundled elements.

**Para. 87** Lincoln urges the Commission to proceed cautiously and to recognize that similarly structured LEC networks may be so in appearance only. The Notice seeks comment on the tentative conclusion that unbundling of a particular network element by one LEC evidences the technical feasibility of providing the same or a similar element on

an unbundled basis in another, similarly structured LEC network. Differences in LEC's operating support capabilities, including billing and cost support systems, may render a technically feasible point for one LEC, to be an infeasible point for another LEC. Likewise, two LECs with identical switch types (e.g. DMS100) may appear similarly structured, yet are not if the software updates and release versions are not identical to support the same signaling and the same services.

**Para. 89** Expanded Interconnection and ONA can be used as a baseline for terms and conditions. In response to the Commission's questions concerning minimum requirements, Lincoln suggests that the Commission adopt the terms and conditions established in Expanded Interconnection and ONA as the baseline for provision of network elements. This would ensure that terms and conditions are consistent across all competitive offerings while maintaining industry standards.

The Commission should not require small and mid-size LECs to provide electronic ordering interfaces. These interfaces need unified, automatic ordering systems. This could require a radical restructuring of the way a LEC provides service to its end users. Re-engineering customer service systems only for the purpose of supporting a competitor would be extremely profligate. This significant cost would need to be spread over only those end users that selected the competitor to provide local service making this interface prohibitively expensive. The Commission itself recognizes that these interfaces are of most value in regional markets. Small and mid-size carriers do not generally serve these markets.

**Para. 113**    The proposed LEC testing plan should play a significant role in interconnection. The Notice references a testing plan proposed by a group of Tier 1 LECs<sup>27</sup> (of which Lincoln is a supporting member) to explore and resolve the technical issues, operational considerations and network reliability concerns related to third-party interconnection to LEC AINs. Lincoln suggests this testing plan is the most effective, efficient and safest way of achieving the goal of a reliable network of networks. Lincoln believes this testing plan should play a significant role with regard to the signaling and database elements addressed in this proceeding. The industry is entering into new technological and market environments. It is difficult to believe that anyone knows all the issues to be resolved and the best way of resolving them without going through some kind of discovery process. Lincoln suggests that such a market-based testing plan might be able to be extended into some other areas of interconnection and network unbundling, especially where network reliability may be a concern.

**Paras. 118-119**    The Commission's Pricing Principles should only apply to agreements in which the state must arbitrate. Paragraph 118 of the NPRM states the Commission's belief that the statute, "is reasonably read to require that we establish pricing principles interpreting and further explaining the provisions of Section 252 (d) for the states to apply in establishing rates in arbitrations. . . ." (emphasis added). Paragraph 119 requests comment on this and other tentative conclusions. Lincoln's view is that when

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<sup>27</sup> Letter from Sandra Wagner, Director, Federal Regulatory, SBC Communications, Inc., to William F. Catton, Acting Secretary, FCC (June 23, 1995).

the Commission adopts pricing principles, the statutory language requires that the principles should only apply to agreements in which the state must arbitrate, and do not apply to agreements which are successfully negotiated without arbitration. In other words, successfully negotiated agreements which do not meet any pricing principles adopted could not be rejected by states for that reason; such agreements could only be rejected under the criteria stated in Section 252 (e) (2) (A).

Lincoln believes that the Commission should not promulgate detailed rules for price levels or structures for the states to follow, but rather develop a high-level framework to guide any necessary arbitration by the states based on the principles we include in our response to Para. 128.

**Para. 128** Total costs should be the guiding principle for pricing. Lincoln has concerns about the pricing methodologies discussed in the Notice. Lincoln asserts that the rates for interconnection and unbundled elements should take into account the total cost of the firm rather than being based on TSLRIC or LRIC alone. Rates set at LRIC or TSLRIC would not allow LECs to recover total costs. A LEC which does not receive rates that cover its total costs over the long run cannot stay in business and continue to provide local network service. Any requirement that rates be set below cost is confiscatory.

Regulations which limit the recovery of costs must be analyzed under the Constitution's Takings Clause.<sup>8/</sup> A constitutional inquiry is vital because any regulations

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<sup>8/</sup> See *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 308-310 (1989)(state regulation of rates may violate Constitution if it prevents sufficient compensation); *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944)(rates limiting ability to attract investors are

that prohibit LECs from covering their costs have a direct impact on a carrier's ability to attract capital. Eliminating the usefulness of the LEC's investment without just compensation would create direct conflicts with the Fifth and Fourteenth Amendments to the Constitution. Lincoln also is concerned that the Commission's approach will not take into account the full range of costs which Lincoln assumed it would recover at the time it made a decision to invest in particular facilities. Prohibiting recovery of those sunk costs at this point would not affect future rights but would retroactively affect vested property rights in recovery of sunk costs. Any such interference with existing property rights must survive constitutional scrutiny to be upheld. Lincoln does not believe that proposals to retroactively deny LECs the right to recover costs they legitimately anticipated would be recovered will be able to survive such scrutiny.<sup>9/</sup>

Lincoln believes that in order to recover total costs, LEC's rates for interconnection and unbundled elements of the network should, at a minimum, include not only LRIC, which Lincoln considers to be the forward-looking direct costs of a product, but also an economically efficient allocation of the forward-looking joint (shared) costs of providing a group of products, or a group customers, and common (overhead) costs supporting the existence of the LEC, and an appropriate share of embedded or historic costs related to past investments in the network.

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confiscatory).

<sup>9/</sup> See *Penn. Central Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978).

Long-run incremental costs (LRIC) will vary with the output of a particular product. Joint costs are not related to one product, but rather to a group of products or group of customers. Common costs do not vary with the output of any one or group of products, but are related to the operation and output of the entire LEC.

**Paras. 129-130** Total costs include joint and common costs. Joint and common costs are necessary cost components of multiproduct firms like local exchange carriers. Joint and common costs create economic efficiencies of scale and scope that lower the total costs of the LEC and the incremental cost of individual services. The exclusion of joint and common costs would encourage the LEC to invest in less efficient technologies that have higher incremental costs and lower shared costs. Lincoln believes this could potentially lead to increasing the prices of some services and be contrary to the intent of the Act.

**Para. 132** Transitional pricing issues need to be addressed with care. Lincoln interprets the transitional interim period referred to in Paragraph 132 as being the time required to negotiate and arbitrate the specifics of an agreement to transfer interconnection services and unbundled network elements to a competitive LEC. Lincoln strongly opposes any transfer of services or network elements during the interim period because it removes the incentive for prompt negotiation.

Lincoln also believes that a transitional pricing mechanism set at short-run marginal cost would encourage competitive LECs to stretch the negotiation period out for as long as possible. Since the short-run marginal cost of providing most telecom services is close

data will not reflect the true costs of doing business in a particular region, or differences in cost due to distance or density. Small and mid-size local exchange carriers might be particularly harmed by averages developed from a much larger scale of geographic and demographic coverage and scope of services. Lincoln objects to using existing interconnection and unbundling arrangements as proxies; the Commission itself cites in Paragraph 138 of the Notice the disadvantages of such an approach, including the fact that these existing rates may not reflect underlying costs and that the existing structure of services may not be comparable to the new structure. Lincoln believes that the use of current access rates as proxies suffers from similar deficiencies especially in their historical linkage to rate of return based rates precluded by the Act.

**Para. 144** Historical or embedded costs are also a component of LEC total costs.

They represent the unrecovered portion of past investment in the network. Networks evolve over time and will never contain only the very latest technology. Lincoln believes that the exclusion of historic or embedded costs from the rate making process would discourage LECs from investing in more technologically advanced networks.

Historical or embedded costs were incurred by the incumbent local exchange carrier under the regulatory oversight of the FCC and state commissions and have been subject to depreciation rates scheduled by the FCC and other regulators. Any rate setting mechanism prohibiting or preventing the recovery of these costs would deprive LECs of the assumptions under which the investments were made, limit LECs' ability to stay in

ceilings in the rate making process of this proceeding. All services cannot be priced at a floor defined as LRIC or TSLRIC without threatening economic efficiencies or violating confiscatory standards. Ceilings may well discourage the deployment of advances in network technology by undermining the associated competitive incentives. Floors and ceilings cannot be applied to individual services out of the context of their application to other services and must be done such that total cost is recovered in the aggregate of the rates for all services. The fact that a competitive carrier can select the individual services it wishes to purchase from the LEC intensifies these problems.

The total cost methodology we described as a guiding principle in reference to Paragraph 128 addresses these issues. The LRIC of a service that the methodology begins with could be considered a type of floor. The methodology includes increases from that "floor" by considering economic considerations related to the individual service in the context of other and all services provided by the company. It may be appropriate for some services to be priced near that "floor". This would require other services to be priced higher, however, this would be done in the manner that makes the most economic sense as determined by the negotiation and arbitration process. The aggregate total costs of the company could be considered a kind of ceiling. The negotiation and arbitration process would also consider the appropriateness of the costs included in the "ceiling" and make the economically rational decisions about the inclusion, sharing and allocation of those costs.

Proxies may not be appropriate. Lincoln generally opposes the use of proxies because of their sacrifice of economic efficiency for expediency. Generic or average cost

to zero, this would amount to confiscation of LEC facilities during the interim period. It is also not clear that the statutory authority for a price mechanism for the interim period exists. The Commission's consideration of a transitional pricing mechanism is intended to address a concern with respect to the unequal bargaining power of the established LEC. The advantage the competitive LEC has in picking and choosing the rates and services for which it wants to negotiate must also be recognized.

**Para. 133** Geographic rate averaging should not be required. The Notice seeks comment on whether interconnection and unbundled element rates should be set on a geographic basis. Lincoln believes that interconnection and unbundled element rates should not be required to be geographically averaged. Lincoln agrees that uneconomic incentives can accompany geographically averaged rates, as the Commission notes in Paragraph 133 of the Notice. However, Lincoln believes geographical averaging would deny many customers the economically efficient effects of competitive choice. This would be true, especially when competing local exchange carriers will not be required to average rates and will be free to pick and chose customers they want to serve. Averaging is contrary to cost causation and distorts proper economic choice. The extent of de-averaging or disaggregation should be determined in the negotiation and arbitration process at levels that make economic and competitive sense.

**Paras. 134-143** Problems exist with floors and ceilings in the ratemaking process. The Notice also addresses the use of "outer boundaries" for reasonable rates, such as rate ceilings and floors. Lincoln believes that there are significant problems with floors and

business and would be considered confiscatory. The appropriate efficient allocation of embedded costs could be determined through the negotiation and arbitration process.

**Paras. 149-151** Lincoln supports the idea that costs should be recovered in a manner that reflects the way they were incurred. Lincoln believes that the costs of shared facilities should be efficiently apportioned among users of that shared facility. For shared facilities whose cost varies with capacity, it is efficient to set prices using utilization factors. Using a capacity approach, without taking into account the utilization of shared facilities, would not allow small and mid-size LECs to recover their total costs, because they lack economies of scale and scope.

**Para. 154** Lincoln believes that volume and term discounts should be allowed. They should be offered on nondiscriminatory conditions to all competing entrants. Volume discounts are due to economies of scale and are purely cost driven. Term discounts represent the reductions in the volatility of costs and the associated risk premium due to longer agreements and therefore are just, reasonable, and based on cost.

### **3. Resale Obligations of Incumbent LECs**

**Para. 176** Lincoln has significant concerns about the resale provisions in the Act. At current rates, certain types of resale could allow competitive local exchange carriers to profit from the existing rate structure without making any capital investments. These arbitrage opportunities between classes of services would create inefficient economic incentives. They could deter competitive carriers from undertaking investments that would improve the existing network technology, quality, and cost of service and prevent facilities-

based competition, especially in the areas where it might be most beneficial to the subscribers.

In Section 251(c)(4)(B), Congress recognized that certain kinds of arbitrage are not in the public interest. Lincoln believes that the Commission should encourage states to adopt certain restrictions preventing such arbitrage. Lincoln would support a reasonable list of restrictions specified by the Commission for the states to use as a guide.

**Paras. 184-188** Rate rebalancing should be encouraged. The Act suggests that there are distinct pricing mechanisms for wholesale rates and the rates for unbundled elements. Lincoln believes that such a distinction can create serious distortions and inefficiencies in the circumstance where the existing LEC's retail rate for a service is below cost. Applying pricing standards specified by the Act for wholesale rates and rates for unbundled network elements without considering the existing relationship between a LEC's costs and rates would lead to the following economic problems: (1) discourage competitive carriers from purchasing unbundled elements of the network priced at cost where it could purchase wholesale services priced below cost; (2) create riskless arbitrage opportunities between the resale services and interconnection and unbundling elements; and (3) encourage inefficient carriers to enter the local market. Lincoln believes that the most efficient way of resolving all of these problems is in rate rebalancing prior to offering services for resale.

In Paragraph 187 of the NPRM, the Commission seeks comments on the relative advantages and detriments of state policies, including one from Illinois that required rate

rebalancing before applying an imputation rule. Lincoln supports a requirement for rate rebalancing whether there is an imputation rule or not. Rebalancing would encourage the efficient facilities-based competition promoted by the Act without requiring ongoing and potentially burdensome regulatory oversight.

Rebalancing will be necessary in any retail service that either provides or receives a subsidy. Possibilities include business and residential local rates, local rates and toll rates, urban rates and rural rates and the rates for complimentary services such as basic local and custom calling or enhanced services. The service being subsidized will be over consumed, and the service providing the subsidy will be lost to competitors that provide the same complimentary services at rates without the subsidy. Using an external funding mechanism, such as USF, to replace the lost subsidy does not address all the previously cited economic problems of services priced below cost.

Rebalancing would allow the resolution of another economic problem associated with the consumers' demand for LECs' services. Many services the LEC offers to subscribers, such as call forwarding and caller ID, are complimentary to basic local services. Subscribers can demand those services only if they have already purchased the basic local service. Therefore, if a competing company becomes the provider of basic local services to the subscriber, it will also become a provider of complimentary services. The current rate structure for basic local service and services complimentary to it still reflect the universal service goals: basic local rates are far below incremental cost, and rates for complimentary services are above their incremental costs. If resellers are able to purchase

services separately, they will pick the ones which are below cost, such as basic local service. Resellers would then build their own facilities to provide complimentary services rather than purchase these from the LEC at wholesale rates that may still be above cost. Therefore, the LEC will lose the ability to provide some of the services without proper compensation.

**C. Obligations Imposed on "Local Exchange Carriers" by Section 251(b)**

**5. Reciprocal Compensation for Transport and Termination of Traffic**

**Para. 232-234** There is no reason for the costing principle for the transport and termination of traffic to be different from the costing principle for interconnection and unbundled elements. Lincoln believes the difference in statutory language is just that, and not a difference in intended costing principles. The concept of total cost Lincoln supports for Section 252(d)(1) is equally applicable to Section 252(d)(2)'s "reasonable approximation of the additional costs of terminating such calls." The negotiation and arbitration process will need to focus on cost causation and consider what is included in each rate and how much of each element used is paid for in other rates.

**Para. 232** The two pricing provisions of Section 252(d) can be viewed consistently as long as the Commission recognizes transport and termination of traffic from one local exchange carrier to another local exchange carrier traffic as usage sensitive. The Act, in Section 252(d)(2), specifically refers to the "calls" that are originated and terminated on competing networks, and calls are billed on a usage sensitive basis.